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FHA Single-Family Mortgage Insurance: Recent Policy Changes and Proposed Legislation

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Summary

The Federal Housing Administration (FHA), an agency of the Department of Housing and Urban Development (HUD), insures private mortgage lenders against losses on eligible mortgages. If a borrower defaults on an FHA-insured mortgage, FHA will repay the lender the remaining amount owed. FHA insurance is intended to encourage lenders to offer mortgages to households who might otherwise have difficulty obtaining a loan at an affordable interest rate, such as households with small down payments. Borrowers pay fees, called premiums, in exchange for the insurance, and these fees are supposed to pay for the costs of any mortgage defaults.

In recent years, increasing foreclosure rates and falling house prices have strained FHA's single-family mortgage insurance fund, the Mutual Mortgage Insurance Fund (MMI Fund). At the end of FY2013, FHA received $1.7 billion from Treasury to ensure that it had sufficient funds to cover all of its expected future losses on the mortgages that it was currently insuring. This was the first time that FHA had ever required funds from Treasury for this purpose for its single-family program.

In response to concerns about the financial condition of the MMI Fund, FHA has taken a number of steps in recent years to attempt to improve its financial position. These changes have included increasing the fees that it charges to borrowers, adjusting its underwriting standards, and making changes to the way that it manages delinquent mortgages and foreclosed properties. FHA has also requested additional authorities from Congress, such as improving its ability to hold FHA-approved lenders accountable for the mortgages they submit for FHA insurance. These authorities have been included in legislation that Congress has considered but have not been enacted to date.

Congress has also been considering additional reforms to FHA. Proposed reforms include increasing the amount of capital that FHA is required to hold in reserve to pay for unexpected increases in future losses and specifying actions that FHA must take if its capital reserves fall below certain thresholds. Some of these proposed additional reforms have been included in several stand-alone bills that have been introduced in recent Congresses, including H.R. 1145 and S. 1376 in the 113th Congress.

Additionally, reforms to FHA are being considered in the context of broader reforms to the housing finance system. One housing finance reform bill in the 113th Congress, the Protecting American Taxpayers and Homeowners (PATH) Act (H.R. 2767), would have made more far-reaching changes to FHA than those that have been included in other bills. These changes would have included limiting FHA-insured mortgages to only low- and moderate-income borrowers and first-time homebuyers in most circumstances, reducing the share of a mortgage that FHA can insure, and requiring greater risk-sharing with the private sector. The PATH Act would also have removed FHA from HUD and made it an independent agency.

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Introduction

The Federal Housing Administration (FHA), an agency of the Department of Housing and Urban Development (HUD), insures private mortgage lenders against the possibility that a borrower will default on his or her mortgage. If the borrower does default, and the home goes to foreclosure, FHA will pay the lender the remaining principal amount owed on the mortgage. FHA insurance is intended to encourage lenders to offer affordable mortgages to certain eligible borrowers who might find it difficult to obtain a conventional (that is, non-government-insured) mortgage, such as households with small down payments. FHA requires a 3.5% down payment for most mortgages it insures, which is lower than the down payment required for most conventional mortgages.[1]

Through its single-family mortgage insurance program, FHA insures eligible mortgages used to purchase or refinance a single-family home.[2] A lender must be approved by FHA to be eligible to offer FHA-insured mortgages, and borrowers and mortgages must meet certain underwriting and eligibility criteria to qualify for FHA insurance. Borrowers also pay fees, called premiums, in exchange for the insurance.

FHA's single-family mortgage insurance program is intended to be self-supporting.[3] The money that it brings in from the fees charged to borrowers and any amounts that it recoups from the sale of foreclosed homes is intended to cover the costs of any claims paid to lenders when mortgages default. However, in recent years increasing foreclosures on FHA-insured mortgages and factors such as house price declines have put pressure on the single-family mortgage insurance fund, known as the Mutual Mortgage Insurance Fund (MMI Fund). At the end of FY2013, FHA was required to take a $1.7 billion mandatory appropriation from Treasury to ensure that it would have sufficient funds to cover all of its expected future losses on the loans that it was currently insuring.[4] FHA did not need any funds from Treasury for this purpose in FY2014.

Furthermore, by statute, the MMI Fund is required to maintain a capital ratio of 2%. This means that it is supposed to have an economic value that is equal to at least 2% of the total dollar volume of mortgages that it is currently insuring, where the economic value is the current net assets of the MMI Fund plus the net present value of the estimated future cash flows on the mortgages that it currently insures. In other words, it is a measure of the amount of funds that would be expected to be available to cover any unexpected future losses on the loans that it currently insures, beyond what is needed to cover expected losses. The capital ratio fell below 2% in FY2009, and has

[1] Generally speaking, a borrower who has less than a 20% down payment will usually need to get mortgage insurance. This could be from a private company (private mortgage insurance, or PMI) or a government agency like FHA. Most mortgages that are not insured by FHA or another government agency will require at least a 5% down payment along with PMI, although in December 2014 Fannie Mae and Freddie Mac each announced that they will begin to accept certain mortgages with down payments as low as 3% with PMI.

[2] Single-family homes are defined as properties with one to four dwelling units. FHA also insures mortgages on multifamily buildings and healthcare facilities, as well as reverse mortgages for senior citizens, but these programs are not addressed in this report.

[3] While FHA's single-family insurance operations are intended to be self-supporting, FHA does receive appropriations to pay for staff salaries and administrative contract expenses.

[4] FHA received these mandatory funds under permanent and indefinite budget authority included in the Federal Credit Reform Act of 1990 (FCRA, Title V of P.L. 101-508). FCRA governs the way in which federal credit programs (including FHA) are accounted for in the federal budget, and provides federal credit programs with permanent and indefinite budget authority to cover any future increases in the costs of loans and loan guarantees.

remained below 2% since then, turning negative in FY2012 and FY2013. In FY2014, the capital ratio was once again positive, but at 0.41% remained below the 2% statutory requirement.[5]

FHA has made a number of policy changes in recent years to attempt to improve its financial condition. Congress has also been considering additional reforms to FHA. This report describes recent policy changes made by FHA and recent legislative proposals that would make additional changes to FHA's single-family program. For the most part, this report does not go into detail about the features of FHA-insured loans, FHA's market role, or its financial status, except as necessary to describe implemented or proposed policy changes. For more information on the features of FHA-insured loans and FHA's role in the mortgage market, see CRS Report RS20530, *FHA-Insured Home Loans: An Overview* , by Katie Jones. For details on the financial status of the MMI Fund, see CRS Report R42875, *FHA Single-Family Mortgage Insurance: Financial Status of the Mutual Mortgage Insurance Fund (MMI Fund)*, by Katie Jones.

Selected Recent FHA Policy Changes

FHA has made several changes to its single-family insurance programs, particularly since FY2010, to attempt to improve its financial status. Recognizing that there is a tension between FHA's mission of expanding access to mortgage credit and its need to maintain the financial soundness of the MMI Fund, these changes generally attempt to improve FHA's financial soundness without unduly limiting access to mortgages for creditworthy borrowers. FHA has the authority to make some of these changes administratively, through policy guidance or rulemaking procedures, while others require congressional action.

The policy changes that FHA has made in recent years generally attempt to increase FHA's cash reserves, to decrease the riskiness of the mortgages it insures, or both. Many of the changes that FHA has made or could make—including increasing premiums and strengthening underwriting criteria—impact the risk profile of future loans that FHA will insure rather than loans that FHA has already insured. FHA has fewer options at its disposal for making changes that will reduce its risk related to loans that it already insures. However, it has taken some steps that address past loans as well as future loans, such as more aggressively holding lenders accountable for loans they originated that did not meet FHA's criteria, making changes to its procedures for addressing delinquent mortgages (known as loss mitigation), and implementing new methods of selling foreclosed properties (known as property disposition).

This section describes several major policy changes that FHA has proposed or implemented in recent years. The changes are divided into three broad categories:

- changes to eligibility and underwriting criteria (including changes to the premiums borrowers pay),
- changes intended to enhance FHA's oversight of lenders, and
- changes to the way in which FHA handles delinquent mortgages and foreclosed properties.

[5] U.S. Department of Housing and Urban Development, *FY2014 Annual Report to Congress on the Financial Status of the FHA Mutual Mortgage Insurance Fund*, http://portal.hud.gov/hudportal/documents/huddoc?id=FY2014FHAAnnRep11_17_14.pdf.

Changes to FHA's Eligibility and Underwriting Criteria

Mortgages that FHA insures must meet certain underwriting standards and otherwise comply with FHA requirements.[6] Some of the changes that FHA has initiated over the past several years involve increasing the premiums that borrowers pay for FHA-insured mortgages and strengthening the underwriting guidelines for its single-family program. The premium increases are intended to ensure that FHA is charging enough for its insurance to cover its potential costs, as well as to build up additional funds that can be used to pay for higher-than-expected losses on loans that FHA insures. The underwriting changes are aimed at making FHA-insured mortgages less likely to default, and therefore likely to result in fewer insurance claims that FHA has to pay. However, as a result of these underwriting and premium changes, some prospective homebuyers may find that they are no longer eligible for FHA insurance, or that FHA-insured mortgages are no longer an affordable option for them.

Changes to Mortgage Insurance Premiums

Borrowers of FHA-insured mortgages pay both *upfront* and *annual* mortgage insurance premiums (MIPs). The upfront premium is paid when the loan is originated and is calculated as a percentage of the original loan amount.[7] The annual premiums are paid each year and are calculated as a percentage of the outstanding loan amount. The premiums represent a large portion of the cash flow into FHA's single-family insurance fund.

The maximum levels of both the upfront and annual mortgage insurance premiums are set in statute, but FHA can administratively set the actual premiums it charges, as long as it does not exceed the statutory maximum.[8] In recent years, FHA has made a series of changes to the premiums it charges to new borrowers, increasing the premiums several times before announcing a decrease in the annual premiums in January 2015.

Table 1 shows the current upfront and annual premiums charged by FHA compared to the maximum premium levels allowed by statute.

Table 1. FHA Single-Family Mortgage Insurance Premiums (MIPs)

Since January 26, 2014

Loan-to-Value Ratio	Statutory Maximum Upfront MIP	Current Upfront MIP	Statutory Maximum Annual MIP	Current Annual MIP
Less than or equal to 95%	3.0%	1.75%	1.50%	0.80%
Above 95%	3.0%	1.75%	1.55%	0.85%

Source: Table created by CRS based on FHA Mortgagee Letters 12-04 and 15-01.

Notes: Different premiums apply to certain types of mortgages, such as streamline refinances, mortgages with shorter loan terms, and reverse mortgages.

[6] The underwriting requirements for FHA-insured loans are found in HUD Handbook 4155.1, *Mortgage Credit Analysis for Mortgage Insurance on One- to Four-Unit Mortgage Loans*, available at http://portal.hud.gov/hudportal/HUD?src=/program_offices/administration/hudclips/handbooks/hsgh. Some of the major features of FHA-insured loans are summarized in CRS Report RS20530, *FHA-Insured Home Loans: An Overview* , by Katie Jones.

[7] The upfront premium is usually financed into the loan amount; therefore, in practice, borrowers generally pay the upfront premium over time as part of their monthly mortgage payments.

[8] The maximum mortgage insurance premium amounts that FHA can charge are codified at 12 U.S.C. §1709(c)(2).

The upfront premium that FHA is currently charging is 1.75% of the loan amount, compared to a maximum of 3% allowed by statute. The annual premium varies slightly depending on the initial loan-to-value ratio (LTV) of the mortgage. The annual premiums are currently 0.85% of the loan balance (or 0.80% of the loan balance if the initial LTV is 95% or less), compared to a maximum of 1.55% (or 1.50% if the initial LTV is 95% or less) allowed by statute.[9] The current premiums are reduced from premiums of 1.35% and 1.30%, respectively, before the premium decrease in January 2015. These annual premiums are lower than any time since early October 2010, although they are higher than the premiums that were charged prior to that date.

For the most part, the changes to the premiums have been made administratively by FHA, although Congress required an increase in the annual mortgage insurance premium of 10 basis points (one-tenth of one percent) in the Temporary Payroll Tax Cut Continuation Act of 2011 (P.L. 112-78). Congress also passed legislation in 2010 raising the maximum statutory annual premium that FHA is allowed to charge, which allowed FHA to make subsequent increases to the annual premium.[10] The changes to the premiums since October 1, 2008, are shown in **Table 2**, along with their effective dates and the FHA administrative guidance (known as Mortgagee Letters) that implemented the changes.[11]

Table 2. FHA Mortgage Insurance Premium Changes Since October 1, 2008

			Annual Premium	
FHA Mortgagee Letter	Effective Date	Upfront Premium	LTV 95% or below	LTV above 95%
ML 2008-22	October 1, 2008	1.75%	.50%	.55%
ML 2010-02	April 5, 2010	2.25%	(no change)	(no change)
ML 2010-28[a]	October 4, 2010	1.00%	.85%	.90%
ML 2011-10	April 18, 2011	(no change)	1.10%	1.15%
ML 2012-04[b]	April 9, 2012	1.75%	1.20%	1.25%
ML 2013-04[c]	April 1, 2013	(no change)	1.30%	1.35%
ML 2015-01	January 26, 2015	(no change)	0.80%	0.85%

Source: FHA Mortgagee Letters

Notes: Premiums shown apply to most FHA single-family mortgages assigned case numbers on or after the effective date; premium changes do not affect the premiums borrowers pay on existing FHA-insured mortgages.

[9] Different annual premiums apply to certain types of mortgages, such as streamline refinances or mortgages with shorter loan terms. Furthermore, FHA charges higher annual mortgage insurance premiums for mortgages with initial principal balances above $625,500, the conforming loan limit for Fannie Mae and Freddie Mac mortgages in high-cost areas. As of January 1, 2014, the maximum loan amount that FHA can insure in high cost areas fell to $625,500 from $729,750; therefore, FHA is no longer insuring any new purchase loans with principal balances above $625,500.

[10] When FHA began raising its premiums in 2010, it was charging the maximum annual mortgage insurance premium allowed by statute. Therefore, FHA raised the upfront premium, and asked Congress for authority to increase the annual mortgage insurance premium. Congress passed legislation increasing the maximum annual mortgage insurance premium that FHA can charge in August 2010 (P.L. 111-229), and FHA subsequently raised the annual premiums while lowering the upfront premium to a lower level than it had been charging at the beginning of 2010. Since that time, FHA has since increased the upfront premium back to what it was charging at the beginning of 2010.

[11] FHA's mortgagee letters can be accessed at http://portal.hud.gov/hudportal/HUD?src=/program_offices/administration/hudclips/letters/mortgagee.

Lower premiums apply for mortgages with loan terms of 15 years or less, and different mortgage premiums apply to certain specialized types of mortgages.

a. P.L. 111-229, enacted on August 12, 2010, increased the maximum annual premium that FHA was allowed to charge. Previously, FHA had been charging the statutory maximum. Given the new higher allowable annual premiums, FHA increased the annual premium it charged and reduced the upfront premium.

b. This Mortgagee Letter implemented a 10 basis point increase in the annual mortgage insurance premium that had been required by P.L. 112-78. The Mortgagee Letter also implemented higher annual premiums for loans that had initial principal balances above $625,500 effective June 11, 2012.

c. This Mortgagee Letter also put into effect a policy that requires payment of the annual mortgage insurance premium for the life of the loan in most cases. Previously the annual premium payments could be canceled when the loan-to-value ratio reached 78%. This policy change is discussed further in the following section.

There has been much debate about the appropriate level for FHA's premiums. Prior to the reduction in the annual premiums in January 2015, several housing and mortgage industry and consumer groups had called on FHA to lower the premiums, arguing that the higher fees were making FHA-insured mortgages too expensive and may have been making it harder for some creditworthy borrowers to obtain FHA-insured loans.[12] Those in favor of lowering the premiums also argue that setting the premiums too high could harm the FHA insurance fund by reducing the number of borrowers who obtain FHA mortgages (and thus pay fees to FHA) or by leading only riskier borrowers to seek FHA loans while less risky borrowers are able to obtain more affordable loans elsewhere.[13]

Other observers have been critical of the decision to lower premiums, particularly while FHA's capital ratio remains below the 2% level required by statute. They note that lowering the premiums is likely to slow FHA's efforts to rebuild its capital reserves. This, in turn, raises concerns that FHA may not have enough funds to cover any increase in its expected costs in the event of another housing or economic downturn and that it could eventually require additional assistance from Treasury (and ultimately taxpayers). Critics of the decision also note that, while premiums that are set too high could lead lower-risk borrowers to seek other types of loans and negatively affect the overall credit quality of FHA's business, premiums that are set too low could also negatively impact the insurance fund. This could happen if the lower premiums lead to an increase in the number of higher-risk borrowers that take out FHA-insured loans without adequately pricing for that risk.[14] Finally, some argue that lowering the FHA fees makes mortgage insurance offered by private companies (known as private mortgage insurance, or PMI) less competitive with FHA for some borrowers, possibly expanding the government's role in the mortgage market when many would like to see the government's role reduced.[15]

Changes to the Premium Cancellation Policy

In addition to changing the amount of the premiums charged, FHA has also changed the length of time that borrowers have to pay the annual mortgage insurance premium. Since 2001, FHA had followed a policy of cancelling borrowers' annual mortgage insurance premiums when the mortgage balance reached 78% of the home's value (based on the initial value of the home),

[12] For example, see a January 7, 2015 letter signed by multiple organizations to HUD Secretary Julian Castro at https://cdn.americanprogress.org/wp-content/uploads/2015/01/FHA-Premiums-Coalition-Letter-2015.01.07.pdf.

[13] For example, see a December 18, 2014 letter from the Mortgage Bankers Association to HUD Secretary Julian Castro at http://www.ohiomba.org/wp-content/uploads/2014/12/MBA-Letter-to-Julian-Castro.pdf.

[14] For example, see Mark A. Calabria, "FHA: On Mortgage Insurance and Adverse Selection," Cato Institute, January 9, 2015, http://www.cato.org/blog/fha-mortgage-insurance-adverse-selection .

[15] For example, see Andy Winkler, "Reducing FHA Premiums: Policy & Market Implications," American Action Forum, January 27, 2015, http://americanactionforum.org/research/reducing-fha-premiums-policy-market-implications.

provided that the borrower had paid the premium for at least five years.[16] Effective June 3, 2013, FHA re-instituted a policy of requiring most borrowers to pay the annual mortgage insurance premium for the life of the loan.[17] This policy only affects borrowers who take out FHA-insured mortgages after the effective date.

FHA made this policy change because, unlike private mortgage insurers, it continues to insure the entire remaining loan balance for the life of the loan regardless of the loan-to-value ratio. Furthermore, the fact that the premiums were canceled when a mortgage reached 78% of the *initial* value of the home (rather than the *current* value of the home), combined with decreases in home prices in recent years, meant that some borrowers could have had their premiums canceled when they actually had very little equity in the home based on the home's current value. This resulted in FHA paying some claims on defaulted mortgages for loans on which borrowers were no longer paying mortgage insurance premiums, and where the home's value was not high enough to recoup the amount of the claim that FHA paid.[18]

Changes to Down Payment and Credit Score Requirements

FHA has also increased the required down payment for borrowers with lower credit scores. For most FHA-insured loans, the required down payment is 3.5%. Beginning on October 4, 2010, FHA has required a down payment of at least 10% from borrowers with credit scores between 500 and 579, while the down payment requirement of 3.5% remains in place for borrowers with credit scores of 580 or above.

Prior to making this change, the required FHA down payment was 3.5% for most borrowers, except that borrowers with credit scores below 500 were required to make a down payment of at least 10%. FHA no longer insures loans made to borrowers with credit scores below 500.[19] FHA has stated that it had not insured many loans where the borrower's credit score was below 500, but that the loans that it did insure with borrower credit scores below that threshold have performed appreciably less well than loans to borrowers with higher credit scores.[20]

Implementing a higher down payment requirement for borrowers with lower credit scores is aimed at addressing concerns about "risk layering," or the possibility that a loan may be at a higher risk of default when it exhibits multiple risk factors rather than just one risk factor.[21] Lower credit scores and higher loan-to-value ratios (that is, borrowing a higher amount relative to the total value of the home) are both potential risk factors. Increasing down payment

[16] See FHA Mortgagee Letter 00-38.

[17] FHA Mortgagee Letter 13-04. Borrowers who take out mortgages with loan-to-value ratios above 90% will be required to pay the annual MIP for the life of the loan or for the first 30 years of the mortgage, whichever is shorter. Borrowers who take out FHA-insured loans with loan-to-value ratios equal to or less than 90% will be required to pay the annual MIP for the life of the loan or for the first 11 years of the mortgage, whichever is shorter.

[18] U.S. Department of Housing and Urban Development, *Annual Report to Congress on the Financial Status of the Mutual Mortgage Insurance Fund, FY2012*, November 16, 2012, p. 54, http://portal.hud.gov/hudportal/documents/huddoc?id=F12MMIFundRepCong111612.pdf.

[19] U.S. Department of Housing and Urban Development, FHA Mortgagee Letter 10-29, "Minimum Credit Scores and Loan-to-Value Ratios," September 3, 2010, http://www.hud.gov/offices/adm/hudclips/letters/mortgagee/files/10-29ml.pdf.

[20] U.S. Department of Housing and Urban Development, "Federal Housing Administration Risk Management Initiatives: Reduction of Seller Concessions and New Loan-to-Value and Credit Score Requirements," 75 *Federal Register* 41221, July 15, 2010.

[21] Department of Housing and Urban Development, "Federal Housing Administration Risk Management Initiatives: Reduction of Seller Concessions and New Loan-to-Value and Credit Score Requirements," 75 *Federal Register* 41218, July 15, 2010.

requirements (and, therefore, reducing the loan-to-value ratio) for borrowers with credit scores below 580 is intended to help address that concern.

Table 3 summarizes FHA's current down payment requirements.

Table 3. Required Down Payments for FHA-Insured Mortgages

Effective as of October 4, 2010

Credit Score	Previous Required Down Payment	Current Required Down Payment
Below 500	10%	Not eligible for FHA insurance
500-579	3.5%	10%
580 or above	3.5%	3.5%

Source: FHA Mortgagee Letter 10-29

FHA made these changes to down payment requirements through rulemaking procedures, and it published a *Federal Register* notice on July 15, 2010, soliciting public comment on these and other changes.[22] HUD then issued a Final Rule addressing only these changes on September 3, 2010,[23] along with administrative guidance providing additional information on the implementation of these changes.[24]

Figure 1 illustrates the distribution of borrowers' credit scores by dollar volume of loans insured by FHA in each year between FY2005 and FY2014. The share of the total dollar volume of FHA-insured loans made to borrowers with lower credit scores decreased over this time period, and the share made to borrowers with higher credit scores increased, particularly beginning in FY2009.

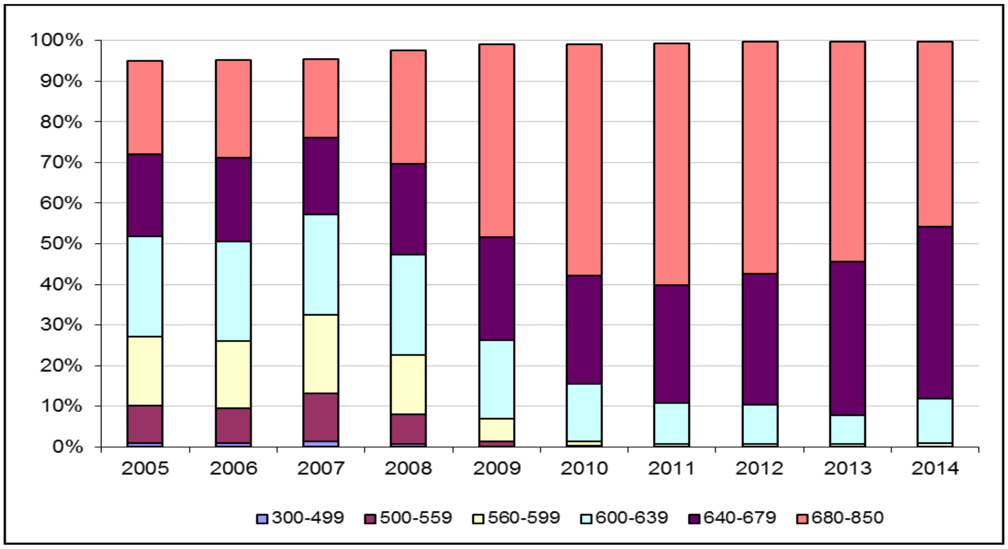
[22] Department of Housing and Urban Development, "Federal Housing Administration Risk Management Initiatives: Reduction of Seller Concessions and New Loan-to-Value and Credit Score Requirements," 75 *Federal Register* 41217-41225, July 15, 2010.

[23] Department of Housing and Urban Development, "Federal Housing Administration Risk Management Initiatives: New Loan-to-Value and Credit Score Requirements," 75 *Federal Register* 54020-54023, September 3, 2010.

[24] Department of Housing and Urban Development, FHA Mortgagee Letter 10-29, "Minimum Credit Scores and Loan-to-Value Ratios," September 3, 2010, http://www.hud.gov/offices/adm/hudclips/letters/mortgagee/files/10-29ml.pdf.

Figure 1. Percentage of Newly Originated FHA-Insured Mortgages (by Dollar Volume) by Borrower Credit Score

FY2005-FY2014



Source: Figure created by CRS based on data from Integrated Financial Engineering, Inc., *Actuarial Review of the Federal Housing Administration Mutual Mortgage Insurance Fund Forward Loans for Fiscal Year 2014*, prepared for the Department of Housing and Urban Development, p. 44.

Notes: Missing data in each year ranges from a low of 0.31% in FY2012 to a high of 4.66% in FY2006. FY2014 is based on partial year data.

In each year between FY2005 and FY2007, roughly 30% of FHA-insured loans (by dollar volume) were made to borrowers with credit scores below 600. Since then, the share of mortgages made to such borrowers dropped to below 10% in FY2009 and to 1% or less each year since FY2011. Given this shift towards FHA serving fewer borrowers with credit scores below 600 in recent years, the down payment changes for the borrowers with the lowest credit scores might currently affect only a relatively small share of potential borrowers. However, if borrowers with higher credit scores begin turning to the conventional mortgage market and private mortgage insurance, and if FHA seeks to return to a more traditional role of insuring a higher proportion of mortgages made to borrowers with lower credit scores, it is possible that more borrowers who traditionally might have sought out FHA-insured mortgages could find themselves unable to qualify based on their credit scores and the higher down payment requirements.

As the share of FHA loans to borrowers with lower credit scores decreased, the share of loans made to borrowers with higher credit scores increased. In FY2011, nearly 60% of the loans that it insured were to borrowers with credit scores of 680 or above, compared to about 20% of loans made to such borrowers in FY2007. In FY2014, based on partial year data, the share of FHA loans made to borrowers with credit scores of 680 or above was about 45%, a decrease of close to nine percentage points compared to FY2013. The share of FHA loans made to borrowers with credit scores between 640 and 679 increased by nearly five percentage points, to 42% from 38%.

While the change in the distribution of borrower credit scores in recent years may partly reflect the changes in down payment requirements for borrowers with lower credit scores, it likely also reflects the general tightening of mortgage credit in the aftermath of the housing downturn, when even some borrowers with strong credit scores might have had difficulty accessing private alternatives for mortgage insurance, and some borrowers with lower credit scores might not have been able to obtain a mortgage at all. In addition, an increase in the loan limits for FHA-insured mortgages, particularly in high-cost areas, may have made FHA-insured loans an option for more borrowers with better credit scores who live in those areas.[25]

Proposed Reduction in Allowable Seller Concessions

In the same 2010 *Federal Register* notice that included the changes in down payment requirements for borrowers with lower credit scores, FHA proposed reducing the amount of seller concessions it will allow. FHA modified this proposal in a 2012 revised notice,[26] but has not yet issued a final rule implementing this proposed change.

"Seller concessions" are any contributions to the borrower's closing costs or other settlement expenses that are made by the seller or any other interested third party. Specifically, FHA proposes reducing the amount of allowable seller concessions to the greater of (1) 3% of the lesser of the home's purchase price or appraised value or (2) $6,000. Currently, FHA allows seller concessions of up to 6% of the lesser of the sale price or the appraised value.[27] The notice also revises the items that count as seller concessions.[28]

FHA maintains that limiting seller concessions to 3% would be in line with industry standards for loans with loan-to-value ratios similar to FHA's, and that FHA-insured loans with higher amounts of seller concessions have performed more poorly in the past.[29] While higher amounts of seller concessions will not be absolutely prohibited, any amount of seller concessions above the 3% threshold will result in a reduction of the mortgage amount that FHA will insure.

Provisions included in FHA reform legislation that was introduced, but not enacted, during the 113th Congress would have required FHA to finalize the rules or, alternatively, would have implemented the 3% cap on seller concessions by statute. These bills are discussed in the "Legislative Proposals in the 113th Congress" section of this report.

Manual Underwriting Requirements

For most mortgages that will be insured by FHA, lenders can use an automated underwriting system to underwrite loans. However, certain FHA mortgages must be underwritten manually rather than through the automated system. For example, mortgages must be manually underwritten for borrowers with no credit history.

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[25] By statute, mortgages cannot exceed a certain principal amount in order to be eligible for FHA insurance. These maximum mortgage amounts vary by area. For more information on the FHA loan limits, see CRS Report RS20530, *FHA-Insured Home Loans: An Overview* , by Katie Jones.

[26] FHA first announced this proposed change in its July 2010 notice and request for public comment on several risk management initiatives; see Department of Housing and Urban Development, "Federal Housing Administration Risk Management Initiatives: Reduction of Seller Concessions and New Loan-to-Value and Credit Score Requirements," 75 *Federal Register* 41220, July 15, 2010. In February 2012, in response to public comments, FHA issued a notice revising its proposal and soliciting comments on the revisions. See Department of Housing and Urban Development, "Federal Housing Administration (FHA) Risk Management Initiatives: Revised Seller Concessions," 77 *Federal Register* 10695-10707, February 23, 2012.

[27] See HUD Handbook 4155.1, *Mortgage Credit Analysis for Mortgage Insurance*, Chapter 2, Section A.3 for information on interested third party contributions and FHA-insured loans.

[28] See the February 2012 revised proposal at 77 *Federal Register* 10697.

[29] Department of Housing and Urban Development, "Federal Housing Administration Risk Management Initiatives: Reduction of Seller Concessions and New Loan-to-Value and Credit Score Requirements," 75 *Federal Register* 41220, July 15, 2010. For example, FHA notes that seller concessions are capped at 4% of the sales price for loans guaranteed by the VA.

The same July 2010 notice that proposed changes to FHA's down payment requirements and the reduction in seller concessions also proposed changes to FHA's manual underwriting requirements. A final notice published in December 2013 implements the new requirements.[30] These changes generally attempt to reduce FHA's risk from manually underwritten loans while ensuring that creditworthy borrowers retain access to FHA-insured mortgages. They are effective for loans that are assigned FHA case numbers on or after April 21, 2014.

In general, to qualify for an FHA-insured mortgage, a borrower's housing debt must not exceed 31% of his or her income (a 31% mortgage debt-to-income ratio, or DTI), and total debt must not exceed 43% of income (a 43% total DTI). If a borrower exceeds these debt-to-income ratios, he or she may still be able to qualify for an FHA-insured loan by showing that certain compensating factors are present, such as substantial savings or a history of sustaining higher housing debts. The new manual underwriting requirements are more specific about how many compensating factors must be present to approve a loan that exceeds the DTI ratios, as well as how high of a DTI will be permitted if compensating factors are present. The new manual underwriting requirements also require borrowers whose loans are manually underwritten to have cash reserves equal to at least one monthly mortgage payment.

The notice also lowers the minimum credit score with which borrowers can exceed the DTI ratios if they exhibit compensating factors from 620 to 580. This change is intended to continue to provide access to credit for some borrowers who may have otherwise found it difficult to qualify for FHA-insured loans due to the new manual underwriting requirements.

Prohibition on Seller-Funded Down Payment Assistance Loans

Another eligibility change that was made to improve FHA's finances, but that was initiated prior to most of the changes discussed in this report, was a prohibition on FHA insuring new loans that benefitted from a practice known as seller-funded down payment assistance (SFDPA).[31] Under SFDPA programs, borrowers would receive a gift of funds for a down payment from a nonprofit agency, and the seller of the home would later make a contribution to the nonprofit agency in the amount of the down payment. This allowed the borrower to essentially receive funds for the down payment from the seller of the home (even though FHA prohibits down payment funds from coming directly from the seller), since the seller's funds were not technically being used for the borrower's down payment.[32]

[30] Department of Housing and Urban Development, "Federal Housing Administration (FHA) Risk Management Initiatives: New Manual Underwriting Requirements," 78 *Federal Register* 238, December 11, 2013. FHA's Mortgagee Letter 2014-02, issued in January 2014, provides additional guidance to lenders on the new manual underwriting requirements.

[31] §2113 of P.L. 110-289.

[32] For more information on seller-funded down payment assistance, see Government Accountability Office, *Mortgage Financing: Additional Action Needed to Manage Risks of FHA-Insured Loans with Down Payment Assistance*, November 2005, http://www.gao.gov/assets/250/248463.pdf.

Although FHA had proposed to stop insuring loans that benefitted from SFDPA in a 1999 proposed rule,[33] it withdrew that proposal in 2001 in response to opposition to the proposed change.[34] FHA again proposed prohibiting SFDPA programs as acceptable sources of down payment funds in 2007.[35] Ultimately, Congress acted to prohibit FHA from insuring new loans with SFDPA in the Housing and Economic Recovery Act of 2008 (P.L. 110-289).

Proponents of seller-funded down payment assistance programs argued that they helped people who could afford mortgage payments but would not be able to save up the cash for a large down payment to become homeowners. However, critics argued that the cost of this down payment assistance often resulted in a higher sales price, meaning that the cost was ultimately paid by the borrower.

FHA's data indicate that loans with seller-funded down payment assistance have performed particularly poorly. FHA insured over 1 million loans with seller-funded down payment assistance between 1998 and 2009, and according to FHA data, these loans have had claim rates that are much higher than those of other FHA-insured loans.[36] According to the results of an annual actuarial review, the economic value of the MMI Fund would be $16 billion higher if FHA had never insured SFDPA mortgages.[37]

Changes to FHA's Lender Requirements

In order to originate mortgages that will be insured by FHA, a lender has to be approved by FHA. FHA-approved lenders must meet certain criteria, and the loans that they submit for FHA insurance must meet FHA's standards.

Loans that do not meet FHA's requirements, but are submitted for FHA insurance, can cost FHA money if they default in the future. Therefore, FHA can take certain actions against lenders who submit mortgages for insurance that do not meet FHA's standards. These actions can include suspending lenders from FHA programs or terminating their approval to originate FHA-insured mortgages entirely as well as imposing civil money penalties. HUD's Mortgagee Review Board (MRB) reviews cases of lenders not complying with FHA requirements and enters into agreements to bring lenders into compliance or imposes penalties where necessary.[38] HUD can

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33 Department of Housing and Urban Development, "Sources of Homeowner Downpayment," 64 *Federal Register* 49956-49958, September 14, 1999.

34 Department of Housing and Urban Development, "Withdrawal of Proposed Rule on Sources of Homeowner Downpayment Pursuant to Section 203 of the National Housing Act," 66 *Federal Register* 2851-2852, January 12, 2001.

35 Department of Housing and Urban Development, "Standards for Mortgagor's Investment in Mortgaged Property," 72 *Federal Register* 27048-27051, May 11, 2007.

36 U.S. Department of Housing and Urban Development, *Annual Report to Congress Regarding the Financial Status of the Mutual Mortgage Insurance Fund, Fiscal Year 2010*, November 15, 2010, pages 24-25, http://portal.hud.gov/hudportal/documents/huddoc?id=DOC_12561.pdf.

37 U.S. Department of Housing and Urban Development, *FY 2014 Annual Report to Congress on the Financial Status of the Mutual Mortgage Insurance Fund*, November 17, 2014, p. 38, available at http://portal.hud.gov/hudportal/HUD?src=/fhammifrpt. The economic value of the MMI Fund is the difference between capital resources that the MMI Fund currently has on hand and the present value of future cash flows on its outstanding loan guarantees. It represents the amount of funds that would remain in the MMI Fund after all expected future cash flows on currently insured loans were realized.

38 For more information on the Mortgagee Review Board, see HUD's website at http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/sfh/mrb/mrbabout.

also refer certain cases to the Justice Department for prosecution under federal statutes such as the False Claims Act or the Program Fraud Civil Remedies Act.

In recent years, FHA has taken a number of steps to increase its oversight of FHA-approved lenders and otherwise manage its counterparty risk. In November 2009, FHA published a proposed rule announcing several changes related to FHA-approved lenders.[39] A final rule implementing the changes was published in April 2010.[40] These and other recent changes include increasing net worth requirements for FHA-approved lenders, eliminating separate FHA approval for mortgage brokers, implementing certain requirements related to FHA-approved lenders that were enacted by Congress in the Helping Families Save Their Homes Act of 2009 (P.L. 111-22), and strengthening certain indemnification requirements.[41]

Some observers have noted that some lenders appear to be less willing to offer FHA-insured mortgages, or to only offer them under more restrictive terms than FHA requires, due to uncertainty about FHA's requirements and concern about the risk that FHA will find a fault with the loan and penalize the lender.[42] In an attempt to provide more clarity to lenders on FHA's requirements and the types of mortgage defects that could trigger certain penalties, FHA has also been in the process of consolidating its requirements for lenders and servicers in a single handbook and making changes to the way in which it evaluates lender and servicer performance.

Net Worth Requirements for FHA-Insured Lenders

The April 2010 final rule increased the net worth requirements for FHA-approved lenders. FHA's rationale for this change is that it will ensure that FHA-approved lenders have sufficient liquidity to withstand market fluctuations and any related losses that they might incur. FHA also notes that the net worth requirements had not been increased since 1993.

The rule increased the net worth requirements to $1 million, with at least 20% of that amount held in cash or its equivalent, effective May 20, 2010, for new applicants and effective May 20, 2011, for lenders who were already FHA-approved. As of May 20, 2013, FHA-insured lenders are required to have a net worth of $1 million, plus an additional 1% of the dollar volume of FHA-insured loans originated, underwritten, purchased, or serviced by the lender in the previous fiscal year that exceeds an aggregate amount of $25 million (up to a maximum net worth requirement of $2.5 million). Twenty percent of this net worth requirement must be held in liquid assets.

Some lenders have raised concerns that the increased net worth requirements could be burdensome for some lenders, and in particular could be more difficult for small lenders to meet

[39] Department of Housing and Urban Development, "Federal Housing Administration (FHA): Continuation of FHA Reform - Strengthening Risk Management Through Responsible FHA-Approved Lenders ," 74 *Federal Register* 62521, November 30, 2009.

[40] U.S. Department of Housing and Urban Development, "Federal Housing Administration: Continuation of FHA Reform: Strengthening Risk Management Through Responsible FHA-Approved Lenders," 75 *Federal Register* 20718-20735, April 20, 2010. A Final Rule providing clarification and correction was published in August 2012. See U.S. Department of Housing and Urban Development, "Federal Housing Administration: Strengthening Risk Management Through Responsible FHA-Approved Lenders," 77 *Federal Register* 51465-51469, August 24, 2012.

[41] See FHA Mortgagee Letter 09-31, "Strengthening Counterparty Risk Management," September 18, 2009, available at http://www.hud.gov/offices/adm/hudclips/letters/mortgagee/2009ml.cfm, for a description of the provisions related to FHA lender monitoring that were enacted in the Helping Families Save Their Homes Act.

[42] For example, see The Urban Institute Housing Finance Policy Center Commentary, "Lifting the Fog around FHA Lending?," by Jim Parrott, March 13, 2014, http://www.urban.org/publications/413053.html.

than large lenders. Some have also raised concerns that increased costs to lenders of complying with these requirements could be passed on to borrowers.[43]

Elimination of Approval of Loan Correspondents

The April 2010 final rule also made changes to FHA's approval and monitoring of entities, such as mortgage brokers, that partner with lenders to originate FHA-insured loans. In order to offer FHA-insured loans, a lender must be approved by FHA. FHA had issued a different type of approval to entities that partner with lenders to originate FHA-insured loans, and it referred to these entities as loan correspondents. The entities it referred to as loan correspondents perform many functions related to originating a mortgage, but cannot underwrite, service, or own FHA-insured mortgages. Full-fledged FHA participating lenders, on the other hand, are authorized to perform all origination functions including underwriting, owning, and servicing FHA-insured loans.

In the April 2010 final rule, FHA announced that it would no longer give FHA approval to loan correspondents. Entities that were previously approved as loan correspondents can continue to participate in the process of originating FHA-insured loans by becoming what FHA now calls third-party originators (TPOs) and partnering with an FHA-approved lender. The FHA-approved lender, not FHA, is now responsible for overseeing TPOs that it partners with and ensuring that they comply with all FHA requirements. TPOs can also apply to become FHA-approved lenders in their own right if they are able to undertake the underwriting, servicing, and ownership functions of FHA-approved lenders.

FHA's rationale for this change is that the lender responsible for underwriting, owning, or servicing the mortgage bears the responsibility for ensuring that their loans meet FHA's standards, and that FHA's approval and oversight resources should be focused on lenders rather than on TPOs. By no longer issuing approval to loan correspondents/TPOs, FHA can focus more of its oversight efforts and resources on the lenders that underwrite, own, and service FHA-insured mortgages. However, some industry participants have raised concerns that removing the separate approval of loan correspondents could make it more difficult for some entities, including small banks, to participate in FHA programs, or could increase costs to FHA-approved lenders who will need to hire new staff to perform functions for which they used to rely on loan correspondents/TPOs. Some have also raised concerns that removing FHA oversight of TPOs could increase risk to the insurance fund if FHA-approved lenders do not adequately oversee TPOs.[44]

FHA stopped approving new applications for approval as loan correspondents on May 30, 2010. Loan correspondents who were already approved retained that approval through December 31, 2010.

Lender Requirements in the Helping Families Save Their Homes Act

The Helping Families Save Their Homes Act (P.L. 111-22), signed into law in May 2009, included several provisions aimed at ensuring that lenders involved in the origination of FHA-

[43] For example, see the discussion of the comments submitted on these changes in the April 2010 Final Rule with request for comment at 75 *Federal Register* 20722. Also, see the discussion of these changes and the concerns that some industry participants have raised in Government Accountability Office, "Federal Housing Administration: Improvements Needed in Risk Assessment and Human Capital Management," November 2011, pp. 28-29, http://www.gao.gov/assets/590/586116.pdf.

[44] For example, see the discussion of the comments submitted on these changes in the April 2010 Final Rule with request for comment at 75 *Federal Register* 20723-20724.

insured mortgages meet certain criteria and giving FHA additional authority to impose penalties on lenders when loans do not meet FHA's standards. Specifically, the law expanded the criteria that would make an entity ineligible to participate in the origination of FHA-insured mortgages, such as if certain of their employees are subjects of certain adverse actions (such as being suspended, debarred, or under a limited denial of participation for federal programs, or indicted or convicted of certain offenses); required FHA-approved lenders to notify FHA if certain actions are taken against a lender or its employees; and expanded FHA's ability to seek civil money penalties for violations of FHA requirements.

While these provisions did not require rulemaking, the April 2010 final rule that addresses other FHA risk management changes also updates FHA regulations to reflect these requirements.

Indemnification Requirements

FHA has also implemented changes through regulation to strengthen its authority to require certain lenders to compensate FHA for insurance claims paid on mortgages that do not meet its requirements. FHA-approved lenders that are approved to originate FHA-insured mortgages under a certain process,[45] the Lender Insurance process, may be required by statute to compensate, or indemnify, FHA in cases of fraud or misrepresentation on the part of the lender or for claims paid on mortgages that did not comply with FHA loan requirements.[46] In October 2010, FHA issued a proposed rule that would clarify these requirements,[47] and in January 2012, FHA issued a final rule implementing these updated requirements.[48]

FHA is also seeking statutory changes that would increase FHA's indemnification authority by extending the indemnification provisions to other FHA-approved lenders in addition to the lenders that are approved to originate loans through the Lender Insurance process. FHA is also seeking changes that would expand its authority to terminate the approval of lenders under certain circumstances. Such provisions have been included in some FHA reform legislation that has been considered by Congress, discussed in the "Legislative Proposals in the 113th Congress" section of this report.

Development of New FHA Single-Family Handbook

FHA has been in the process of developing a new Single Family Handbook to update and consolidate its requirements for originating and servicing FHA-insured single-family mortgages. Provisions requiring FHA to publish a consolidated single-family handbook with guidance for lenders and servicers were included in legislation that was introduced during the 113th Congress but were not enacted into law.

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[45] Certain high-performing FHA-approved lenders can be approved to originate loans under the Lender Insurance process, which allows them to endorse loans for FHA insurance without a pre-insurance endorsement review by FHA. FHA can require indemnification from lenders who originate loans under the Lender Insurance process, but cannot require indemnification from FHA Direct Endorsement lenders who are not approved to originate loans through the Lender Insurance process.

[46] 12 U.S.C. §1715z-21(c)

[47] Department of Housing and Urban Development, "Federal Housing Administration (FHA) Single Family Lender Insurance Process: Eligibility, Indemnification, and Termination," 75 *Federal Register* 62335-62342, October 8, 2010.

[48] Department of Housing and Urban Development, "Federal Housing Administration (FHA) Single Family Lender Insurance Process: Eligibility, Indemnification, and Termination," 77 *Federal Register* 3598-3605, January 25, 2012.

FHA intends for the new handbook to provide clearer guidance to lenders and servicers on the requirements related to FHA-insured mortgages.[49] Providing clearer guidance to lenders on FHA requirements could make lenders more willing to offer FHA-insured mortgages by reducing concerns that the loans will not meet FHA's standards.

FHA is posting draft sections on its website for feedback.[50]

Development of Changes to FHA Quality Assurance Framework

FHA has also been seeking feedback on changes to its framework for assessing problems with FHA-insured loans that do not meet its requirements.[51] The new framework is intended to provide more clarity to lenders on the types of problems FHA may identify with a loan and the severity of different types of problems. Like the FHA Single Family Handbook, the new framework for communicating and assessing problems with FHA-insured mortgages could reduce lenders' uncertainty about what constitutes violations of FHA's requirements and may make them more likely to offer FHA-insured mortgages.

Changes to Loss Mitigation and Property Disposition Actions

When an FHA-insured loan goes into default, FHA requires mortgage servicers to engage in outreach to borrowers and to evaluate whether a borrower might be eligible for a workout solution that would avoid a foreclosure. These options are referred to as loss mitigation actions, because they are intended to limit—or mitigate—the losses to the FHA insurance fund from defaulted mortgages. Under FHA's loss mitigation program, servicers of FHA-insured mortgages are required to evaluate borrowers who are in default for certain loss mitigation options, in a certain order, before proceeding to foreclosure. Servicers are first required to evaluate borrowers for loss mitigation options that will allow the borrowers to keep their homes (such as loan modifications) before evaluating borrowers for options where they will lose their homes but avoid the process of foreclosure (such as short sales).

If loss mitigation is unsuccessful and a property is foreclosed on, the property is generally conveyed to FHA to market and sell. FHA's methods of selling foreclosed properties are referred to as property disposition. To the extent that FHA can increase its returns from selling foreclosed properties, it can reduce the losses to the insurance fund that it incurs from foreclosures. FHA has made a number of changes to both its loss mitigation program and its property disposition methods in recent years.

Changes to Loss Mitigation Programs

FHA has made a number of changes to its existing loss mitigation options that are designed to help borrowers remain in their homes. Specifically, FHA has made changes to make it easier for more borrowers to qualify for loss mitigation options that provide deeper reductions in monthly

[49] See FHA's "Blueprint for Access: What FHA is Doing to Expand Access to Mortgage Credit for Underserved Borrowers," at http://portal.hud.gov/hudportal/documents/huddoc?id=BlueprintAcess5_9_2014.pdf.

[50] Draft sections of the FHA Single Family Handbook are posted on HUD's website at http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/sfh/SFH_policy_drafts.

[51] A draft of the Loan Quality Assessment Methodology is at http://portal.hud.gov/hudportal/documents/huddoc?id=SFH_POLI_LQA.pdf.

mortgage payments.[52] These changes are designed to help more borrowers keep their homes and, consequently, reduce the claims that FHA pays on foreclosures.

Another change that FHA has made is streamlining its short sale policy to try to increase the number of mortgages that are sold in a short sale rather than going through foreclosure. Homes that sell through short sales often result in less of a loss to the insurance fund than foreclosures, partly because they generally sell at higher prices than foreclosures and partly because FHA avoids the costs of maintaining a foreclosed property before it can be sold. Therefore, FHA expects that facilitating more short sales will reduce losses to the MMI Fund.

Additional clarifications to FHA's requirements regarding mortgage servicers' communication with delinquent borrowers and evaluation of borrowers for loss mitigation options are included in a number of Mortgagee Letters published by FHA during 2013 and 2014.[53]

Distressed Asset Stabilization Program

FHA has begun to sell some mortgages in default to investors through a program called the Distressed Asset Stabilization Program (DASP).[54] Through this program, FHA sells pools of FHA-insured mortgages that are at least six months past due, and for which servicers have evaluated borrowers for all loss mitigation options, to the highest bidder. The investors that purchase the mortgages are not allowed to foreclose on the property for six months, during which time the investor and the borrower can try to negotiate a solution to avoid foreclosure. FHA sells these loans through two types of pools: national or regional pools and neighborhood stabilization outcome (NSO) pools. Investors who purchase the neighborhood stabilization outcome pools, which include loans in more specific geographic areas, are required to ensure certain outcomes that are intended to protect the surrounding neighborhood from the impact of foreclosures on at least half of the loans in the pool.[55]

DASP is intended to reduce losses to the FHA insurance fund by removing non-performing mortgages from FHA's outstanding insurance obligations and sparing FHA the costs of maintaining and marketing a foreclosed property. At the same time, it is intended to potentially help borrowers by giving investors an opportunity to offer borrowers workout solutions that FHA might not be able to offer, and to help stabilize neighborhoods by avoiding a situation where many foreclosed properties go on the market at the same time. However, some have raised questions about whether DASP includes sufficient protections for borrowers and whether FHA should do more to help mission-based nonprofits compete for properties through DASP.[56]

[52] See FHA Mortgagee Letter 2012-22, "Revisions to FHA's Loss Mitigation Home Retention Options," November 16, 2012, http://portal.hud.gov/hudportal/documents/huddoc?id=12-22ml.pdf.

[53] FHA Mortgagee Letters are available at http://portal.hud.gov/hudportal/HUD?src=/program_offices/administration/hudclips/letters/mortgagee. For a list of recent FHA Mortgagee Letters related to loss mitigation procedures, see the FY2014 Annual Report to Congress on the Financial Status of the Mutual Mortgage Insurance Fund, page 66-67.

[54] For more information on loan sales under this program, see HUD's website at http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/comp/asset/sfam/sfls.

[55] Federal Housing Administration, *Quarterly Report on FHA Single Family Loan Sales: Data as for May 30, 2014*, p. 4, http://portal.hud.gov/hudportal/documents/huddoc?id=report.pdf.

[56] For example, see Center for American Progress, "Is the FHA Distressed Asset Stabilization Program Meeting Its Goals?," by Sarah Edelman, Julia Gordon, and Aashna Desai, September 2014, http://cdn.americanprogress.org/wp-content/uploads/2014/09/Edelman-DASP-report.pdf.

Additional Property Disposition Actions

FHA has also expanded a pilot program through which certain foreclosed homes are sold directly by lenders rather than being conveyed to FHA to sell.[57] This is referred to as "claim without conveyance of title," because FHA pays the lender an insurance claim but never takes title to the property. It is intended to reduce losses to the MMI Fund by reducing the costs to FHA of managing foreclosed properties before they are sold.

According to FHA, in the fourth quarter of FY2014 its loss severity rate on alternate forms of property disposition—short sales, DASP, and claims without conveyance of title—was 46% of the outstanding mortgage balance, compared to 55% for foreclosed properties where FHA took title to the home and sold it using traditional methods.[58] FHA has been making increasing use of these alternative forms of property dispositions. The share of property dispositions that have utilized one of these alternative methods has increased from under 20% in the fourth quarter of 2012 to 50% in the fourth quarter of 2013 and 75% in the fourth quarter of 2014. The share of alternative property dispositions in the fourth quarter of 2014 was higher than in previous quarters, when the share had fluctuated around 50%.[59]

Legislative Proposals in the 113th Congress

While FHA has taken a number of actions to stabilize its finances in recent years, there are some changes that it cannot make without congressional action. Furthermore, some policy makers believe that additional changes are needed, beyond what FHA has done or has stated that it would do if given legislative authority. Therefore, some policy makers have proposed making additional changes to FHA's single-family program through legislation. Such proposals have included additional changes in underwriting or eligibility requirements to reduce the risk on FHA-insured loans and changes to FHA's capital requirements to require it to hold more funds in reserve to pay for unexpected losses.

Furthermore, some policy makers have advocated making changes to FHA's mortgage insurance standards or business operations to attempt to reduce its role in the mortgage market and bring more purely private capital back into the market. However, others have expressed concern that some of these policy changes—whether aimed at strengthening FHA's finances, decreasing its role in the mortgage market, or both—could make it more difficult for some creditworthy borrowers to obtain FHA-insured mortgages.

In both the 111th and 112th Congresses, bills containing certain FHA reforms were passed by the House of Representatives but were not considered by the Senate.[60] The bills passed by the House in each of these Congresses were not the same, but they contained some similar provisions, including some that have been sought by FHA in recent years to provide it with additional

[57] U.S. Department of Housing and Urban Development, *FY2012 Annual Report to Congress on the Financial Status of the Mutual Mortgage Insurance Fund*, November 16, 2012, p. 53, http://portal.hud.gov/hudportal/documents/huddoc?id=F12MMIFundRepCong111612.pdf.

[58] U.S. Department of Housing and Urban Development, *FHA Single-Family Mutual Mortgage Insurance Fund Programs, Quarterly Report to Congress, FY2014 Q4*, December 11, 2014, p. 23, http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/rmra/oe/rpts/rtc/fhartcqtrly.

[59] Ibid.

[60] In the 111th Congress, the FHA Reform Act of 2010 (H.R. 5072) was passed by the House of Representatives. In the 112th Congress, the FHA Emergency Fiscal Solvency Act of 2012 (H.R. 4264) was passed by the House in September 2012. A bill identical to the House bill (S. 3678) was introduced in the Senate in December 2012 but was not considered by either the committee or the full Senate. There have been other bills in recent Congresses that would have made various changes to FHA, but most of these bills were not reported out of committee.

authority for monitoring lenders. For example, while the specifics differed, these bills both would have provided FHA with increased authority to terminate lenders' FHA approval under certain circumstances and to require indemnification when insured mortgages did not meet FHA's requirements.

During the 113th Congress, the FHA Emergency Fiscal Solvency Act of 2013 (H.R. 1145) was introduced in the House, but was not reported out of committee. The bill contained some of the changes that were included in the bills passed by the House in the 111th and 112th Congresses.

Two additional bills related to FHA were ordered to be reported out of committee in the 113th Congress: the FHA Solvency Act of 2013 (S. 1376), which was reported in the Senate, and the Protecting American Taxpayers and Homeowners (PATH) Act (H.R. 2767), which was ordered to be reported in the House. While H.R. 1145 and S. 1376 only address FHA, the PATH Act includes FHA provisions as part of a broader bill to reform the housing finance system. The PATH Act is also the most far-reaching of these bills, and includes a number of provisions that are aimed at more narrowly targeting FHA insurance to certain populations and bringing more purely private capital into the mortgage market.

This section briefly describes some of the major provisions included in these FHA reform bills introduced in the 113th Congress. It does not provide a comprehensive discussion of every provision contained in these bills.

House Bills

FHA Emergency Fiscal Solvency Act of 2013 (H.R. 1145)

The FHA Emergency Fiscal Solvency Act was not reported out of committee in the 113th Congress, but it contained similar provisions to bills that passed the House in previous Congresses. Among other things, this bill would have done the following:

Mortgage Insurance Premiums

The bill would have required a minimum annual mortgage insurance premium of 0.55%. The bill would also have raised the maximum annual premium that FHA is allowed to charge to 2.05% (2% for mortgages with loan-to-value ratios at or below 95%) from 1.55% (1.50% for mortgages with loan-to-value ratios at or below 95%).

Capital Requirements

Under current law, FHA is required to maintain a capital ratio of 2%. (The capital ratio is defined as the economic value of the MMI Fund—that is, the Fund's current capital resources plus the expected net present value of the future cash flows on the mortgages that it currently insures—divided by the total dollar amount of mortgages that FHA is currently insuring.) The capital ratio has been below this 2% threshold for several years. FHA is also required to contract with an independent actuary each year to perform an actuarial review of the MMI Fund.

H.R. 1145 would have required FHA to provide more frequent actuarial reviews of the MMI Fund when its capital ratio falls below 2%. It would also have required FHA to submit an emergency capital plan describing actions it would take to restore the capital ratio when the ratio fell below the required threshold. Finally, the bill would have required the Government Accountability Office (GAO) to submit a report on FHA's safety and soundness.

Lender Oversight

The bill would have expanded FHA's ability to seek indemnification for certain mortgages while requiring FHA to establish an appeals process for lenders to appeal indemnification decisions. It would also have increased FHA's ability to terminate a lender's approval to originate FHA-insured loans under certain circumstances.

Additional Provisions

Additional provisions included, among others, a requirement that HUD submit a report examining opportunities for streamlining FHA programs.

Protecting American Taxpayers and Homeowners (PATH) Act (H.R. 2767)

The PATH Act was a broader bill to reform the housing finance system that was ordered to be reported out of the House Financial Services Committee. Title II of the bill included extensive provisions related to FHA. Some of these included versions of provisions that had also been included in other bills in some form, including a number of changes to lender oversight, premiums, and capital requirements. Other provisions would have made additional, more far-reaching changes to FHA, including making it an independent agency, taking steps to more narrowly target FHA insurance, and reducing the amount of FHA's insurance coverage and increasing the role of private capital. These provisions were intended to better target FHA insurance to those who most need it, and to improve FHA's financial soundness. However, some expressed concern over the potential impacts that these provisions could have on credit availability or affordability for some households.[61]

Among several other provisions, the PATH Act, as ordered to be reported out of committee, would have done the following:

FHA Structure

The bill would have removed FHA from HUD and made it a free-standing agency.[62]

Eligibility and Underwriting

The bill would have limited FHA insurance to mortgages made to first-time homebuyers or low- and moderate-income homebuyers (defined as families with incomes less than 115% of area median income, or families with incomes less than 150% of area median income in designated high-cost areas). FHA would have been allowed to insure mortgages made to households that did not meet these criteria in times of tight credit availability or in areas affected by disasters.[63]

The minimum down payment would have been increased to 5% for non-first-time homebuyers, and the maximum dollar amount of a mortgage that can be insured by FHA would have been reduced in some non-high-cost areas.[64] The bill would have prohibited FHA from insuring any

[61] For example, see a July 23, 2013 letter from the Mortgage Bankers Association on an earlier draft of the legislation at http://www.mbaa.org/files/MBALtrtoRep.HensarlingonPATHAct.pdf.

[62] §211 of H.R. 2767, as ordered to be reported out of committee.

[63] §232 of H.R. 2767, as ordered to be reported out of committee.

[64] Ibid.

mortgages where seller concessions exceeded 3%.[65] It would also have prohibited FHA from insuring mortgages in any areas that had used eminent domain to acquire mortgages within the past 10 years.[66]

Mortgage Insurance Premiums

The bill would have required a minimum annual mortgage insurance premium of 0.55% of the mortgage balance, and would have required that FHA set its premiums at a level adequate to cover its administrative and personnel costs as well as the costs of insurance and maintaining the capital ratio.[67]

Capital Requirements

The bill would have increased the capital ratio requirement for mortgages insured after the bill was enacted to 4% from the current 2%. It would have required the capital ratio to be determined quarterly, and placed restrictions on the loan-to-value ratios of the mortgages that FHA could have insured if the capital ratio fell below certain thresholds.[68] FHA's financial reports would have been required to use accounting methods that are used in the private sector.[69]

Lender Oversight

The PATH Act would have provided FHA with increased authority to require compensation from lenders under certain circumstances when mortgages did not meet FHA's standards while requiring FHA to establish an appeals process for lenders to appeal indemnification decisions.[70] FHA would have been required to publish a consolidated handbook with all of its origination and underwriting requirements for lenders and servicers.[71]

Role of Private Capital

The bill would have gradually reduced the share of the original principal amount of the mortgage that FHA can insure to 50% from 100% over a five-year period.[72] It would also have required FHA to establish risk-sharing demonstration programs to transfer some of the credit risk of FHA-insured mortgages to other entities.[73]

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[65] §263 of H.R. 2767, as ordered to be reported out of committee.

[66] §266 of H.R. 2767, as ordered to be reported out of committee.

[67] §235 of H.R. 2767, as ordered to be reported out of committee. Under current law, FHA receives appropriations to cover the costs of staff salaries and administrative contract expenses.

[68] §256 and §257 of H.R. 2767, as ordered to be reported out of committee.

[69] §253 of H.R. 2767, as ordered to be reported out of committee.

[70] §265 of H.R. 2767, as ordered to be reported out of committee.

[71] §265 of H.R. 2767, as ordered to be reported out of committee.

[72] §234 of H.R. 2767, as ordered to be reported out of committee.

[73] §233 of H.R. 2767, as ordered to be reported out of committee.

Senate Bills

FHA Solvency Act of 2013 (S. 1376)

The FHA Solvency Act, as reported out of the Senate Banking Committee, would also have made several changes related to lender oversight, mortgage insurance premiums, and capital requirements, among other things.[74] It was not as far-reaching as the PATH Act, and would not have taken steps to limit who is eligible for FHA insurance or to bring private capital into the market to the same extent as the PATH Act. Among other provisions, the bill would have done the following:

Eligibility and Underwriting

FHA would have been required to evaluate its underwriting standards and revise them as necessary, taking certain specific factors into account.[75] It would also have been required to finalize its proposed rule on seller concessions (described earlier in this report).[76]

Mortgage Insurance Premiums

The bill would have required a minimum annual mortgage insurance premium of 0.55% of the mortgage balance and increased the maximum annual premium that FHA can charge to 2% or 2.05% (depending on whether the initial loan-to-value ratio is above 95%). It would also have required FHA to review the premiums annually to ensure that they were adequate to maintain the costs of insurance and the capital ratio.[77]

Capital Requirements

The FHA Solvency Act would have raised the required capital ratio to 3% and required FHA to take certain actions if the capital ratio fell below certain thresholds, including imposing premium surcharges on new borrowers and increasing its reporting requirements.[78] It would have required stress testing of the MMI Fund similar to the stress tests required by the Federal Reserve, with the results included in the annual actuarial review, and it would have required FHA and Treasury to notify Congress within 48 hours if FHA drew on its authority with Treasury to fund any of its accounts.[79]

Lender Oversight

The bill would have provided FHA with increased authority to seek compensation from lenders under certain circumstances when a mortgage did not meet FHA's standards while requiring FHA to establish an appeals process for lenders to appeal indemnification decisions.[80] Further, it would have allowed FHA to terminate lenders' approval on a nationwide basis as well as in specific

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[74] Among the provisions of S. 1376 that are not described here are several provisions that would make changes to the Home Equity Conversion Mortgage (HECM) program, FHA's mortgage insurance program for reverse mortgages.

[75] §6 of S. 1376, as reported out of committee.

[76] §12 of S. 1376, as reported out of committee.

[77] §2 of S. 1376, as reported out of committee.

[78] §7 of S. 1376, as reported out of committee.

[79] Amendments to S. 1376 approved by the committee.

[80] §4 of S. 1376, as reported out of committee.

areas.[81] The bill would also have allowed FHA to transfer mortgage servicing to specialty servicers in some cases.[82] FHA would also have been required to issue a consolidated handbook with all of its guidelines for lenders and servicers of FHA-insured mortgages.[83]

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[81] §5 of S. 1376, as reported out of committee.

[82] Amendment to S. 1376 approved by the committee.

[83] §5 of S. 1376, as reported out of committee.